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Supreme Court of the United States

OCTOBER TERM, 1966

Supreme Court, U.S.
FILED
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JOHN F. DAVIS, CLERK

No. 127

FEDERAL POWER COMMISSION,
Petitioner,

v.

UNITED GAS PIPE LINE COMPANY, NATURAL GAS PIPE LINE COMPANY OF AMERICA, AND TEXAS EASTERN TRANSMISSION CORPORATION,
Respondents.

No. 128

MEMPHIS LIGHT, GAS AND WATER DIVISION,
Petitioner,

v.

UNITED GAS PIPE LINE COMPANY, NATURAL GAS PIPE LINE COMPANY OF AMERICA, AND TEXAS EASTERN TRANSMISSION CORPORATION,
Respondents.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

APPENDIX TO BRIEF FOR UNITED GAS PIPE LINE COMPANY

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FIDELITY PRINTING COMPANY, INC., HOUSTON

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APPENDIX A

Excerpts from the Natural Gas Act, the Internal Revenue Code and Regulations

NATURAL GAS ACT

Section 1(b) The provisions of this act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas. [52 Stat. 821 (1938); 15 U.S.C. § 717 (1946)]

CODE (26 USC 1 et seq):

TAX ON CORPORATIONS

§ 11. Tax imposed

(a) *Corporations in general.* — A tax is hereby imposed for each taxable year on the taxable income of every corporation. The tax shall consist of a normal tax computed under subsection (b) and a surtax computed under subsection (c).

(b) *Normal tax.* — The normal tax is equal to the following percentage of the taxable income:

(1) 30 percent, in the case of a taxable year beginning before January 1, 1964, and

(2) 22 percent, in the case of a taxable year beginning after December 31, 1963.

(c) *Surtax.* — The surtax is equal to the following percentage of the amount by which the taxable income exceeds the surtax exemption for the taxable year:

(1) 22 percent, in the case of a taxable year beginning before January 1, 1964,

(2) 28 percent, in the case of a taxable year beginning after December 31, 1963, and before January 1, 1965, and

(3) 26 percent, in the case of a taxable year beginning after December 31, 1964 (as amended by 1964 Revenue Act, ~~28~~ 26 USCA § 11, 1966 Supp.)

Sec. 172 [1954 Code]. (a) DEDUCTION ALLOWED. — There shall be allowed as a deduction for the taxable year an amount equal to the aggregate of (1) the net operating loss carryovers to such year, plus (2) the net operating loss carrybacks to such year. For purposes of this subtitle, the term "net operating loss deduction" means the deduction allowed by this subsection.

(b) NET OPERATING LOSS CARRYBACKS AND CARRYOVERS. —

(1) YEARS TO WHICH LOSS MAY BE CARRIED. — A net operating loss for any taxable year ending after December 31, 1957, shall be —

(A) a net operating loss carryback to each of the 3 taxable years preceding the taxable year of such loss, and

(B) a net operating loss carryover to each of the 5 taxable years following the taxable year of such loss.

(2) AMOUNT OF CARRYBACKS AND CARRYOVERS. — Except as provided in subsection (i), the entire amount of the net operating loss for any taxable year (hereinafter in this section referred to as the "loss year") shall be carried to the earliest of the 8 taxable years to which (by reason of subparagraphs (A) and (B) of paragraph (1)) such loss may be carried. The portion of such loss which shall be carried to each of the other 7 taxable years shall be the excess, if any, of the amount of such loss over the sum of the taxable

income for each of the prior taxable years to which such loss may be carried. For purposes of the preceding sentence, the taxable income for any such prior taxable year shall be computed —

(A) with the modifications specified in subsection (d) other than paragraphs (1), (4), and (6) thereof; and

(B) by determining the amount of the net operating loss deduction without regard to the net operating loss for the loss year or for any taxable year thereafter,

and the taxable income so computed shall not be considered to be less than zero.

(c) NET OPERATING LOSS DEFINED. — For purposes of this section, the term "net operating loss" means (for any taxable year ending after December 31, 1953) the excess of the deductions allowed by this chapter over the gross income. Such excess shall be computed with the modifications specified in subsection (d).

§ 1503. [1954 Code]

* * * * *

(c) REGULATED PUBLIC UTILITY DEFINED. —

(1) IN GENERAL. — For purposes of subsection (b), the term "regulated public utility" means —

(A) A corporation engaged in the furnishing or sale of —

(i) electric energy, gas, water, or sewerage disposal services, or

(ii) transportation (not included in subparagraph (C)) on an intrastate, suburban, municipal,

or interurban electric railroad, on an intrastate, municipal, or suburban trackless trolley system, or on a municipal or suburban bus system, or

(iii) transportation (not included in clause (ii)) by motor vehicle —

if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof, by an agency or instrumentality of the United States, by a public service or public utility commission or other similar body of the District of Columbia or of any State or political subdivision thereof, or by a foreign country or an agency or instrumentality or political subdivision thereof.

(B) A corporation engaged as a common carrier in the furnishing or sale of transportation of gas by pipeline, if subject to the jurisdiction of the Federal Power Commission.

REGULATIONS — 26 CFR:

§ 1.1502-15. **Liability for tax.** — (a) *Several liability of members of affiliated group.* Except as provided in paragraphs (b) and (c) of this section, the common parent corporation and each subsidiary, a member of the affiliated group during any part of a consolidated return period, shall be severally liable for the tax (including any deficiency in respect thereof) computed as provided in § 1.1502-30, and for any addition to the tax computed as provided in § 1.1502-49 for underpayment of estimated tax for the consolidated return period.

§ 1.1502-30. **Computation of tax.** — (a) *General rule.* In the case of an affiliated group which makes, or is required to make, a consolidated return for any taxable year, the

tax liability of each corporation for the period during such year that it was a member of such group shall be computed, subject to the provisions of paragraph (b) of this section, upon the consolidated taxable income and the consolidated taxable income plus the aggregate of the deductions of the several affiliated corporations allowable under section 242, or, in the case of the taxes imposed by section 531, section 541 (except as provided in paragraph (b)(4) of this section), and section 802, upon the consolidated accumulated taxable income, the consolidated undistributed personal holding company income, the consolidated life insurance company taxable income, the consolidated life insurance company taxable income plus the aggregate of the deductions of the several affiliated corporations allowable under section 242, or the consolidated 1954 life insurance company taxable income, as the case may be, determined in each case in accordance with the regulations under section 1502. In the case of an affiliated group realizing long-term capital gains and computing its tax under the alternative tax provisions of section 1201, the tax shall be computed with reference to the consolidated taxable income, and the excess of the consolidated net long-term capital gain over the consolidated net short-term capital loss. The tax imposed under section 11(c) or section 831 shall be increased for any taxable year for which an affiliated group makes or is required to make a consolidated return by 2 percent of the consolidated taxable income (computed without regard to the deduction, if any, provided in section 242 for partially tax-exempt interest).

§ 1.1502-31. **Basis of tax computation**

In the case of an affiliated group of corporations which makes, or is required to make a consolidated return for any taxable year, and except as otherwise provided in the regulations under section 1502, the tax liability determnied

under § 1.1502-30 shall be determined subject to the definitions and rules of computation set forth in paragraphs (a) and (b) of this section.

(a) *Definitions* — (1) *Consolidated taxable income.* The consolidated taxable income shall be the combined taxable income of the several affiliated corporations:

(i) Minus the sum of:

(a) Any consolidated net operating loss deduction,

(b) Any consolidated section 1231 net loss, relating to net losses from involuntary conversions subject to section 1231, and from sales or exchanges of property subject to section 1231,

(c) Any consolidated charitable contribution deduction, but not in excess of 5 percent of the consolidated taxable income computed without regard to such consolidated charitable contribution deduction, any deductions under part VIII (section 241 and following, except section 248), subchapter B, chapter 1 of the Code, any consolidated net operating loss carrybacks, and any deduction under section 922 (special deduction for Western Hemisphere trade corporations),

(d) Any consolidated dividends received deduction,

(e) Any consolidated section 922 deduction,

(f) Any consolidated section 175 deduction, but not in excess of 25 percent of the consolidated section 175 gross income,

(g) Any consolidated section 247 deduction,

(h) Any consolidated section 582(c) net loss, and

(i) [Reserved]

(j) Any consolidated section 181 deduction,

(ii) Plus any consolidated net capital gain, or

(iii) Minus, in the case of an affiliated group including as members one or more corporations subject to the tax imposed by section 831, the combined additional capital loss deductions of such corporations authorized by section 832 (c) (5) (but in an amount not in excess of the consolidated net capital loss).

§ 1.1502-31(b). *Computations.* In the case of affiliated corporations which make, or are required to make, a consolidated return, and except as otherwise provided in the regulations under section 1502:

(1) *Taxable income.* The taxable income of each corporation shall be computed in accordance with the provisions covering the determination of taxable income of separate corporations, except:

(i) There shall be eliminated unrealized profits and losses in transactions between members of the affiliated group and dividend distributions from one member of the group to another member of the group (referred to in the regulations under section 1502 as intercompany transactions);

(ii) No net operating loss deduction shall be taken into account;

(iii) No capital gains or losses shall be taken into account;

(iv) There shall be disregarded all gains and losses from involuntary conversions subject to section 1231, and from sales and exchanges of property subject to section 1231;

(v) In the computation of the deduction under section 171, relating to amortizable bond premium, there shall be disregarded the bonds of one member of the

group owned by another member of the group during the taxable year;

(vi) In the computation of the taxable income of a corporation for the taxable year in which it became the common parent corporation of the affiliated group filing a consolidated return, the aggregate deductions of such corporation for such year otherwise allowable in excess of the gross income of such corporation for such year shall be excluded to the extent that such excess is attributable to that portion of such year preceding the date upon which such corporation became the common parent corporation of the group. Any amount excluded under this paragraph shall, to the extent that it constitutes a net operating loss within the provisions of section 172 or a net capital loss within the provisions of section 1222, be considered as a net operating loss or a net capital loss, as the case may be, separately sustained by such corporation and subject to the provisions of paragraph (a) (3) (ii) or (11) (ii) of this section;

(vii) In the case of a corporation which became a member of the affiliated group after January 1, 1954, common parent corporation or subsidiary, as the case may be, allowable deductions shall be determined subject to the qualifications prescribed in subparagraph (9) of this paragraph;

(viii) No deductions under section 170 with respect to charitable or other contributions shall be taken into account;

(ix) In the case of the deduction provided in section 615 (relating to mine exploration expenditures), the allowable deduction shall be determined subject

to the qualifications prescribed in subparagraph (12) of this paragraph;

(x) In the case of a distribution of inventory to which section 311(b) is applicable, or in the case of a distribution of property to which section 311(c) is applicable by one member of the group to another member of the group, the gain recognized under such sections shall be eliminated;

(xi) No deductions under section 243, 244, 245, or 247 (relating to deductions with respect to dividends received and dividends paid) or under section 922 (relating to the special deduction for Western Hemisphere trade corporations), shall be taken into account;

(xii) No deductions under section 175 (relating to soil and water conservation expenditures) shall be taken into account by a member of an affiliated group to which the consolidated section 175 deduction is applicable;

(xiii) In the case of a bank, for taxable years beginning after December 31, 1958, there shall be disregarded all gains and losses from sales and exchanges of property described in section 582(c); and

(xiv) No deduction under section 181 (relating to deduction for certain unused investment credit) shall be taken into account.

Intercompany profits and losses which have been realized by the group through final transactions with persons other than members of the group, and intercompany transactions which do not affect the consolidated taxable income shall not be eliminated. For the purpose of this subparagraph, gain includible in income pursuant to section 357(c) with respect to transfers of assets other than capital assets and

other than assets to which section 1231 is applicable, and gain includible in income by reason of the application of paragraph (a) (1) (iii) of § 1.1502-37, shall not be eliminated. For the purpose of the regulations under section 1502, a transaction not involving a sale or exchange of a capital asset or of property subject to the provisions of section 1231 shall not be considered an intercompany transaction if such transaction occurs in the regular course of the trade or business of the members of the group and if such members adopt, with the consent of the Commissioner and subject to such conditions as he deems proper, a consistent accounting practice of taking into account in the computation of consolidated taxable income the gains and losses reflected in such transactions: As used in this paragraph, the term "taxable income" includes the case in which the allowable deductions of a member (not including any net operating loss deduction) exceed its gross income. For purposes of section 593(b)(2) (relating to addition to reserve for bad debts), taxable income of an organization to which section 593 applies shall be computed as if such organization filed a separate return for the taxable year.

(2) *Other computations on separate basis.* The various other computations required by the regulations under section 1502 to be made by the several affiliated corporations shall be made in the case of each such corporation in the same manner and under the same conditions as if a separate return were to be filed, but with the following exceptions:

(i) *Taxable income.* The taxable income used in any such computation shall be the taxable income of the corporation determined in accordance with the provisions of this section.

(ii) *Dividends received.* In the computation of the dividends received, there shall be excluded all dividends received from other members of the affiliated group.

(iii) *Capital gains and losses.* Capital gains and losses, short-term capital gains and losses, long-term capital gains and losses, and the additional capital loss deduction authorized by section 832(c)(5) shall be determined without regard to:

(*a*) Gains or losses arising in intercompany transactions (other than gains described in section 357(c)) and gains recognized to the distributing corporation pursuant to section 311(c) by reason of distributions by one member of the group to another member of the group,

(*b*) Gains or losses from involuntary conversions and from sales or exchanges of property subject to the provisions of section 1231,

(*c*) The net capital loss carryovers provided in section 1212,

(*d*) In the case of a corporation which became a member of the affiliated group subsequent to January 1, 1954, common parent corporation or subsidiary, as the case may be, capital losses to the extent disallowed pursuant to the provisions of subparagraph (9) of this paragraph, and

(*e*) In the case of a bank, for taxable years beginning after December 31, 1958, gains or losses from sales or exchanges of property described in section 582(c).

(iv) *Net operating loss.* In the computation of the net operating loss, as defined in section 172, the provisions of this section pertaining to the determination of taxable income shall apply.

(v) *Dividends paid.* In the computation of dividends paid, there shall be excluded all dividends paid

by one member of the group to another, except as provided in paragraph (b)(4) of § 1.1502-30.

(vi) *Federal income tax.* In the computation of the Federal income tax, there shall be used the consolidated tax, or a proportionate part thereof, if the tax payable is properly computed on the basis of the consolidated return.

§ 1.1502-34. **Sale of stock; basis for determining gain or loss.** — (a) *Scope of section.* This section prescribes the basis for determining the gain or loss upon any sale or other disposition (hereinafter referred to as "sale") by a corporation which is (or has been) a member of an affiliated group which makes (or has made) a consolidated return for any taxable year, of any share of stock issued by another member of such group (whether issued before or during the period that it was a member of the group and whether issued before, during, or after the taxable year 1929), and held by the selling corporation during any part of a period for which a consolidated return is made or required under the regulations under section 1502. For the basis in the case of a sale of bonds, see § 1.1502-35.

(b) *Sales made while selling corporation is member of affiliated group.* If the sale is made within a period during which the selling corporation is a member of the affiliated group, whether or not during a consolidated return period, and whether or not, as a result of such sale, the issuing corporation ceases to be a member of the group, the basis shall be determined as follows:

(1) The aggregate bases of all shares of stock of the issuing corporation held by each member of the affiliated group (exclusive of the issuing corporation) immediately prior to the sale, shall be determined separately for each

member of the group, and adjusted in accordance with the other provisions of subtitle A of the Code, but without regard to any adjustment under the last sentence of section 1051 relating to losses of the issuing corporation sustained by such corporation after it became a member of the group.

(2) From the combined aggregate bases as determined in subparagraph (1) of this paragraph, there shall be deducted the sum of —

(i) All losses of such issuing corporation sustained during taxable years for which consolidated income tax returns were made or were required (whether the taxable year 1929 or any prior or subsequent taxable year) after such corporation became a member of the affiliated group and prior to the sale of the stock to the extent that such losses could not have been availed of by such corporation as net loss or net operating loss in computing its net income or taxable income, as the case may be, for such taxable years if it had made a separate return for each of such years,

(ii) With respect to each of such taxable years for which consolidated returns were made or were required both for income and for excess profits tax purposes, the excess, if any, of all losses of such issuing corporation for such year, properly adjusted in the computation of consolidated excess profits net income over the amount of such losses for such year computed under subdivision (i) of this subparagraph to the extent that such excess could not have been availed of by such corporation as a net operating loss in computing its excess profits net income for such taxable years if it had made a separate return for each of such years, and

(iii) With respect to each of such taxable years for which consolidated returns were made or were required for excess profits tax purposes only, all losses of such issuing corporation for such year, properly adjusted in the computation of consolidated excess profits net income, to the extent that such losses could not have been availed of by such corporation as a net operating loss in computing its excess profits net income for such taxable years if it had made a separate excess profits tax return for each of such years,

reduced by any losses of the issuing corporation apportioned under this section to its stock sold or otherwise disposed of in a prior transaction, disregarding any transaction between members of the affiliated group during a consolidated income or excess profits tax return period which did not constitute a partial liquidation of the issuing corporation. For any taxable year in which the group sustained a consolidated loss not availed of in prior or subsequent years as a deduction under net loss or net operating loss provisions, the amount deducted under this subparagraph shall be further reduced by an amount equal to that proportion of such consolidated loss which the loss of the issuing corporation for the year in which such loss was sustained bears to the aggregate losses of the members of the group for such year.

(3) The sum of the aggregate bases of all shares of stock, after making the deduction under subparagraph (2) of this paragraph, shall then be apportioned among the members of the affiliated group which hold stock of the issuing corporation, by allocating to each such member that proportion of the sum of the aggregate bases so reduced which the aggregate basis of the stock in the issuing corporation held by such member bears to the sum of the aggregate bases.

(4) The aggregate basis as determined under subparagraph (3) of this paragraph for each member of the affiliated group shall then be equitably apportioned among the several classes of stock of the issuing corporation held by such member according to the circumstances of the case — ordinarily by allocating to each class of such stock that proportion of the aggregate basis which the basis of each class of such stock held by it at the time of the sale is to the sum of the bases of the several classes of such stock held by it.

(5) The basis of each share of stock of each class held by a member of the affiliated group shall then be determined by dividing the basis apportioned to such class under subparagraph (4) of this paragraph by the total number of shares of such class held by it.

• • •

(d) *Definition of "loss", "consolidated loss", "net loss", or "net operating loss", and "consolidated excess profits net income".* As used in this section the term "loss" means either the excess over the gross income of the issuing corporation of the sum of its allowable deductions (not including any net loss or net operating loss deduction) allowable in computing consolidated taxable income or the excess over the gross income of the issuing corporation of the sum of its allowable deductions (not including any net loss or net operating loss deduction), plus the proportionate part properly attributable to such corporation of the credits relating to interest on certain Government obligations and dividends received allowable in computing consolidated normal tax net income, the consolidated special class net income or consolidated net income subject to tax determined in accordance with the Internal Revenue Code of 1939 and provisions of consolidated returns regulations applicable to the period. The term "consolidated loss" means the ex-

cess of the sum of the losses, separately computed, over the sum of the normal tax net income, the special class net income, the net income subject to tax or the taxable income determined in accordance with the provisions of subtitle A of the Internal Revenue Code of 1954, or the Internal Revenue Code of 1939, or the Revenue Act, and pursuant to the provisions of consolidated returns regulations applicable to the period; the term "net loss" or "net operating loss" means the net loss or net operating loss, as the case may be, determined in accordance with the provisions of subtitle A of the Internal Revenue Code of 1954, or the Internal Revenue Code of 1939, or the Revenue Act, and pursuant to the provisions of consolidated returns regulations applicable to the period; and the term "consolidated excess profits net income" means the consolidated excess profits net income or consolidated section 433(a) excess profits net income determined in accordance with the provisions of the Internal Revenue Code of 1939 or the Revenue Act and pursuant to the provisions of consolidated returns regulations applicable to the period.

§ 1.1502-35. **Sale of bonds or other obligations; basis for determining gain or loss.** — In the case of a sale or other disposition by a corporation, which is (or has been) a member of an affiliated group which makes (or has made) a consolidated income tax or excess profits tax return for any taxable year, of bonds or other obligations issued or incurred by another member of such group (whether or not issued or incurred while it was a member of the group and whether issued or incurred before, during, or after the taxable year 1929) and held by the selling corporation during any part of a period for which a consolidated return is made or required under the regulations under section 1502, the basis of each bond or obligation, for determining the gain or loss upon such sale or other disposition, determined

in accordance with the other provisions of subtitle A of the Code, but without regard to any adjustment under the last sentence of section 1051, shall be decreased (except as otherwise provided in this section) by the excess, if any, of the aggregate of the deductions computed under paragraph (b) (2) or (c) of § 1.1502-34 over the sum of the aggregate bases of the stock of the debtor corporation as computed under paragraph (b) (1) or (c) of § 1.1502-34 as the case may be, held by the members of the group. The adjustment with respect to so much of such deductions as is based upon losses sustained during the taxable year 1929 and subsequent taxable years for which the last day prescribed by law for the filing of the return fell on or before March 1, 1945 (the date on which Treasury Decision 5441 was filed with the Division of the Federal Register), and availed of on consolidated returns filed for such years shall be made only in those cases in which the sales or other disposition of such bonds or other obligations resulted in a loss. See also § 1.1502-40 relating to disallowance of loss upon intercompany bad debts.

APPENDIX B

United Gas Corporation and Subsidiaries
Federal Taxable Income or (Loss), Consolidated and Separate Returned Basis
Years 1957 - 1961 Inclusive

Year		Exhibit 36 Revised Docket No. RP63-1 Rounded	Exhibit 36 Revised Docket No. RP63-1 Dollars & Cents	Eliminations Other Adjustments	Eliminations Dividend Adjustments	Separate Returns Basis Total	Separate Returns Basis United Gas Corporation	Separate Returns Basis United Gas Pipe Line Co	Separate Returns Basis Union Producing Co
1957		Consolidated Basis							
	Taxable Income or (Loss):								
	United Gas Corporation	$74,335,687	$74,335,686		$ 77,088,616				
					(15,559,000) (5)				
					(15,190,930) (6)		$ 19,090,756		
	United Gas Pipe Line Co	$ 61,577,879	$ 61,577,879	$ 65,067,978 (4)	27,200,000 (5)	$ 75,708,258		$ 75,708,258	
	Union Producing Co	(769,975)	(769,974.56)	(2,097,257) (4)		(10,379,899)			(10,379,899)
	Total Taxable Income:								
	Per Exhibit 36 (Revised)	$ 135,143,591	$ 135,143,591.09	$ 62,970,721	$ 63,748,108	$ 65,328,359	$ 19,090,756	$ 75,708,258	$ (10,379,899)
	Per Exhibit No. 14-1, Schedule No. 3, Line 2						$ 19,090,756	$ 75,708,258	$ (10,379,899)
	Explanation of Eliminations:								
			Dividends						
	Notes (1), (2) & (3):	Total Dividends Received	Less Amount out of Earnings & Profits	Balance 100%	85% of 100%				
	Received by United Gas Corporation from:								
	United Gas Pipe Line Co	$ 60,000,000		$ 60,000,000	$ 47,600,000				
	Union Producing Co	134,000,000	$ 34,468,998.85	99,531,001.15	84,601,351.13				
	Total Subsidiary Company	194,000,000	$ 34,468,998.85	$ 159,531,001.15	$ 132,201,351.13				
	Duval Sulphur & Potash Co	93,387,948		93,387,948	79,380,861 (2)				
	Total	$ 287,387,948	$ 34,468,998.85	$ 252,918,949.15	$ 211,582,212.13				
	Received by United Gas Pipe Line Co from Southland Paper Mills Inc	$ 37,000,00		$ 37,000,00	$ 31,450,00 (3)				

Note (2) Capital gains of United Gas Pipe Line Company eliminated on consolidation due to United Gas Corporation's capital loss carryover

Note (5) Capital gains of Union Producing Company eliminated on consolidation due to United Gas Corporation's capital loss carryover

Note (6) Contributions of Union Producing Company on behalf of S% limitation - deductible on consolidation

United Gas Corporation and Subsidiaries
Federal Taxable Income or (Loss), Consolidated and Separate Return Basis
Years 1957-1961 Inclusive

	Year		Exhibit 36 Revised Docket No. RP63-1 Recorded	Eliminations Other Adjustments	Eliminations Dividend Adjustments	Total	Separate Returns Basis United Gas Corporation	United Gas Pipe Line Co.	Union Producing Co.
1	1958		Consolidated Basis						
2		Taxable Income or (Loss):							
3		United Gas Corporation	35,285,221		(86,030,253)(1)		18,993,575.69		
4		United Gas Pipe Line Co.	22,573,974	145,596.96(4)	27,300.00 (2)	22,749,181.37		22,749,181.37	
5		Union Producing Co.	4,554,936	143,766.91(5)		4,996,503.10			4,996,503.10
6		Total Taxable Income:							
7		Per Exhibit 36 (Revised)	30,955,531.	289,363.87	1,549,255.21	46,739,560.16			
8		Per Exhibit No. 141, Schedule							
9		No. 4, Line 4					18,993,575.69	22,749,181.37	4,996,503.10
10									
11		Explanation of Eliminations:							
12									
13			Dividends						
14		Note (1), (2) & (3):	Total Dividends Received	Amount Net of Foreign Tax	Balance 100%	55% of 100%			
15									
16		Received by United Gas Corporation from:							
17									
18		United Gas Pipe Line Co.							
19		Union Producing Co.	17,500,000.00	3,326,975.07	14,479,024.93	12,307,171.19			
20		Total Intercompany	17,500,000.00	3,326,975.07	14,479,024.93	12,307,171.19			
21		Sunset Gulphur & Petrol Co.	1,147,538.62		1,147,538.62	975,407.83			
22		Other Processing Co.	12,500.00		12,500.00	10,625.00			
23		Total Other	1,160,038.62		1,160,038.62	986,032.83			(1)
24		Total	18,660,038.62	3,326,975.07	15,333,760.55	13,293,204.02			
25		Received by United Gas Pipe Line Co. from Southland Royalty Co.	32,000.00		32,000.00	27,200.00			(3)
26									
27		Note (4) Capital gains of United Gas Pipe Line Company eliminated in consolidation due to United Gas Corporation's capital loss carryover.							
28									
29		Note (5) Capital gains of Union Producing Company eliminated in consolidation due to United Gas Corporation's capital loss carryover.							
30									
31									
32									
33									
34									

United Gas Corporation and Subsidiaries
Federal Taxable Income or (Loss), Consolidated and Separate Return Bases
Years 1957-1961 Inclusive

Year		Exhibit 36 Revised Docket No. RP63-1 Recorded	Eliminations Other Adjustments	Eliminations Dividend Adjustments	Total	Separate Return Basis United Gas Corporation	United Gas Pipe Line Co.	Union Producing Co.
1959		Consolidated Basis						
	Taxable Income or (Loss):							
	United Gas Corporation	29395944	4355175(4)	(106196875(1)) 27743886(5)	13989301 60	13989301 60		
	United Gas Pipe Line Co.	20943401 13		2720000 (3)	20970601 13		20970601 13	
	Union Producing Co.	(1856398)	1756397 68	(1794516686)	(18332460 2)			(18332460 2)
	Total Taxable Income:							
	Per Exhibit 36 (Revised)	21944598	1690034	11033658544	33126656 71			
	Per Exhibit No. 14-J, Schedule No. 5, Line 2					13989301 60	20970601 13	(18332460 2)
	Explanation of Eliminations:							
			Dividends					
	Notes (1), (2) + (3):	Total Dividends Received	Less Amount not Out of Balance Earnings 1956	Balance 100%	85% or 100%			
	Received by United Gas Corporation from:							
	United Gas Pipe Line Co.	-						
	Union Producing Co.	18500 0000	5556 1331	7944 3556 69	5451 30369			
	Total Intercompany	18500 0000	5556 1331	9943 3556 69(2)	2451 30369			
	Duval Sulphur & Potash Co.	12187500 00		12187500 00	10357 37500			
	Atlas Processing Co.	306250 00		306250 00	260312 50			
	Total Other	12493750 00		12493750 00	10617 68750 (1)			
	Total	30993750 00	5556 1331	11937 4106 69	13069 99119			
	Received by United Gas Pipe Line Co. from Southland Royalty Co.	320000 00		320000 00	272000 00 (3)			

Note (4) Exclusion from taxable income of dividends, interest income and net investment of United Gas Pipe Line Company in bonds applied in reduction of depreciable property basis.

Notes (5) + (6) Contributions of Union Producing Company in excess of 5% limitation - deductible in consolidation.

United Gas Corporation and Subsidiaries
Federal Taxable Income or (Loss), Consolidated and Separate Returns Basis
Years 1957-1961 Inclusive

Year		Exhibit 36 Revised Docket No. RP63-1 Rounded	Eliminations Other Investments	Eliminations Dividend Adjustments	Total	Separate Returns Basis United Gas Corporation	United Gas Pipe Line Co.	Union Producing Co.
1	1960		Consolidated Basis					
2	Taxable Income or (Loss):							
3	United Gas Corporation	$ 760 979	$ 760 977 891	69 188 150 (1)	$ 1 063 562 60 (1)	$ 924 747 71	$ 1 192 474 771	
4	United Gas Pipe Line Co.	17 569 439	17 569 438 66		8 091 815 50 (3)			
5	Union Producing Co.	(4 333 704)	(4 333 703 86)	96 502 205	27 500 00	17 596 638 66		17 596 638 66
6	Total Taxable Income:					(4 237 623 64)		(4 237 623 64)
7	Per Exhibit 36 (Revised)	15 936 714	15 936 713 71	165 691 837	91 817 806 50	925 376 273		
8	Per Exhibit No. 14-J, Schedule No. 6, Line 2							
9						1 192 474 771	17 596 638 66	(4 237 623 64)
10								
11	Explanations of Eliminations:							
12				Dividends				
13		Total	Base Amount					
14	Notes (1), (2) & (3):	Dividends Received	Not Subject to Earnings Test	Balance	100 %	85% of 100%		
15								
16	Received by United Gas Corporation from:							
17	United Gas Pipe Line Co.							
18	Union Producing Co.	18 500 000 00	10 408 981 85	80 910 195	6 877 365 43			
19	Total Intercompany	18 500 000 00	10 408 981 85	80 910 195 (2)	6 877 365 43			
20	Duval Sulphur & Potash Co.	12 187 500 00		12 187 500 00	10 359 375 00			
21	Other Producing Co.	32 500 00		32 500 00	27 625 00			
22	Total Other	12 251 250 00		12 251 250 00	10 663 562 50 (1)			
23	Total	19 751 250 00	10 408 981 85	93 161 445	7 940 927 93			
24	Received by United Gas Pipe Line Co. from Southland Royalty Co.	32 000 00		32 000 00	27 200 00 (3)			
25								
26	Note (4) Exclusion from Taxable income of 85% of interest income on advancements of United Gas Pipe Line Company's bonds - applicable reduction of depreciable property basis.							
27								
28	Note (5) Contributions of Union Producing Company in excess of 5% limitation - deductible in consolidation.							

United Gas Corporation and Subsidiaries
Federal Taxable Income or (Loss), Consolidated and Separate Return Basis
Years 1957-1961 Inclusive

	Year		Exhibit 36 Revised Docket No. RP61-1 Rounded		Eliminations Other Adjustments	Eliminations Dividend Adjustments	Total	Separate Return Basis United Gas Corporation	United Gas Pipe Line Co.	Union Producing Co.	United Overseas Production Corporation
			Consolidated Basis								
1	1961										
2		Taxable Income or (Loss):									
3		United Gas Corporation	(2,887,741)	(2,887,741.23)	769,117.72 (4)	$ 176,356,750.00	$ 167,517,132.99	$ 167,517,132.99			
4		United Gas Pipe Line Co.	185,583,900	185,583,900.07		27,222,617.08	186,155,900.07		186,155,900.07		
5		Union Producing Co.	(1,602,855)	(1,602,855.05)	934,026.66 (5)		(668,828.39)			(668,828.39)	
6		United Overseas Production Corp.	(243,554)	(243,553.50)			(243,553.50)				(243,553.50)
7		Total Taxable Income:									
8		Per Exhibit 36 (Revised)	155,150,100	155,150,139.07	1,703,144.38	195,907,625.08	352,760,909.17				
9		Per Exhibit No. 141, Schedule									
10		No. 7, Line 4						167,517,132.99	186,155,900.07	(668,828.39)	(243,553.50)
11											
12		Explanation of Eliminations:									
13					Dividends						
14			Total	Less Amount							
15		Notes (1), (2) & (3):	Dividends	Not Out of	Balance						
16			Received	Earnings or Profits	14.29%	85.71% of 102%					
17		Received by United Gas Corporation									
18		from:									
19		United Gas Pipe Line Co.	119,000,000.00		14,001,000.00	119,000,000.00					
20		Union Producing Co.	45,000,000.00		4,500,000.00	38,250,000.00					
21		Total Intercompany	185,000,000.00		18,501,000.00 (2)	157,250,000.00					
22		Duval Sulphur & Potash Co.	12,187,500.00		1,218,750.00	10,359,375.00					
23		Other Processing Co.	325,000.00		32,500.00	276,250.00					
24		Total Other	12,512,500.00		1,251,250.00	10,635,625.00	(1)				
25		Total	197,512,500.00		19,752,250.00	167,885,625.00					
26		Received by United Gas Pipe Line									
27		Co. from Louisiana Paper Mills, Inc.	32,000.00		3,200.00	27,200.00	(3)				
28											
29		Note (4) Exclusion from taxable income of debt retirement income on retirement									
30		of United Gas Pipe Line Company's bonds - applied in reducing									
31		of depreciable property bases.									
32											
33		Note (5) Contributions of Union Producing Company in excess of 5%									
34		limitation - deductible in consolidation.									

APPENDIX C

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Before Commissioners: Joseph C. Swidler, Chairman; Howard Morgan, L. J. O'Connor, Jr., Charles R. Ross, and Harold C. Woodward.

CITIES SERVICE GAS COMPANY } Docket No. G-18799

OPINION No. 396 — 30 FPC 158.

OPINION AND ORDER DETERMINING TAX ALLOWANCE, DISALLOWING RATES AND REQUIRING REFUND

(Issued July 15, 1963)

ROSS, Commissioner:

This proceeding is before us on the single question of the proper tax allowance to be included in the cost of service of Cities Service Gas Company (Gas Company) and to be reflected in its rates after our approval on March 27, 1961, of a rate settlement agreement between Gas Company and customers representing almost the entire volume of gas sold by it.[1] The settlement cost of service included federal income taxes in the amount of $7,055,981, calculated at the statutory rate of 52 percent upon Gas Company's return after making all deductions applicable to Gas Company as a separate corporate entity but the Settlement Agreement

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[1] This proceeding involves a locked-in period because Gas Company made a further filing increasing its rates in Docket No. RP62-1, which rates became effective on December 23, 1961, except for Rate Schedules I-1 and I-2 which became effective July 23, 1961.

specifically reserved for future determination the issue of the proper amount of federal income taxes to be allowed Gas Company in this proceeding and provided for refunds as a result of a final order on the tax question.

Gas Company is a member of the Cities Service system. The parent corporation is Cities Service Company, which, through its wholly owned subsidiary, Empire Gas and Fuel Company, owns all the outstanding stock of Gas Company and, altogether, directly or indirectly owns the stock of 37 corporations. Among these Gas Company is the only company engaged in the interstate transportation and sale of natural gas. The other subsidiaries are engaged in a wide range of petroleum activities. Subsidiaries explore for and produce oil and natural gas, not only domestically in Oklahoma, Louisiana, Texas, Illinois, Kansas, Mississippi and New Mexico, but also in the offshore areas of the Gulf of Mexico. Other subsidiaries produce petroleum products in Canada, Columbia, Venezuela, Peru, Arabia and the French Sahara. Still other subsidiaries own and operate refineries, oceangoing oil tankers, railroad tank cars, and an office building.

The parent has filed a consolidated tax return for a number of years and Gas Company has been included in the consolidated return except for the years 1950, 1951 and 1952. Under the Internal Revenue Code (Sections 1501-1504) when a consolidated return is filed, all corporations whose stock is owned 80 percent or more by the Parent Company, must be joined in the consolidated return. In the return the losses of any company can be set off against the taxable income of other companies in the group. A net loss in any year can be carried back to the three preceding years or carried forward to the succeeding five years (Sections 172 of the Code). The tax rate on the consolidated

return is 54 percent, instead of the usual 52 percent for a separate corporate income tax return, but the 2 percent penalty applies only to the amount of the consolidated taxable income which exceeds the taxable income that is derived from a utility, such as Gas Company (Section 1503 of the Internal Revenue Code).

The Parent Company has allocated the burden of the consolidated tax payments among the various subsidiaries on the following basis. The regulated companies, such as the Gas Company, were charged 52 percent of their net taxable income while the remainder of the consolidated tax, if any, was then allocated among the nonregulated subsidiaries showing a profit in proportion to their respective taxable incomes. Their intrasystem methods of allocation, of course, cannot be the basis of determining the amount allowable to Gas Company as an operating expense in a rate case.

The staff argues that in computing an allowance for federal income tax to be included in the cost of service the Commission should adhere to its interpretation of the doctrine of actual taxes payable. When any company participates in the filing of a consolidated tax return, it should also participate in any saving generated whichever company is responsible for the saving. The important fact, the staff says, is that Gas Company joins in the Parent Company's consolidated tax returns, so that the taxable income or loss becomes a "fused mass" in which each dollar is indistinguishable from any other dollar. The filing of the consolidated tax return, the staff adds, does not produce any separate income tax liability on the taxable income of the Gas Company, but instead, produces a tax liability for the whole group.

As a result of these views the staff did not apply the statutory rate to Gas Company's taxable income, but rather employed a consolidated effective tax rate of 10.53 percent for the purpose of determining the proper allowance for federal income taxes in Gas Company's cost of service. This tax rate was derived, in essence, by dividing the consolidated tax paid by the Cities Service system by the total taxable income of all the profit making affiliates computed separately for the years 1957, 1958 and 1959.[2] By this method the staff computed an effective tax rate of 23.92 percent for 1957, 0 percent for 1958 (where there was a consolidated tax loss), and 7.67 percent for 1959. It averaged these three figures to obtain its effective tax rate of 10.53 percent which it applied to the Gas Company's income in the test year 1958 to obtain a tax allowance of $785,565.

Cities Service argues that the tax rate actually payable on the Gas Company's stipulated return is 52 percent. It says that taking into account the carry-back of losses, there are no tax savings which can be attributed to the Gas Company's inclusion in the consolidated return. Furthermore, it contends that it is the Gas Company's rates which are in issue here not the rates for the oil, or gasoline, or petrochemicals, or the other products produced and sold by the companies in the Cities Service system. It says that where rates are being set for a utility operation, the costs applicable to that operation are germane, not the costs of the unrelated non-utility operations. It adds that if there is any saving from the non-utility operations they belong to the stockholder who incurred the losses and not to the

[2] Since the test year 1958 showed a consolidated loss, the Staff used the three year period in order to reach a more representative result.

ratepayer, who has paid no obligation of the non-jurisdictional subsidiaries and has not contributed to their losses. The staff's proposal, the companies say, would take away from the investors a portion of the incentive provided by Congress to encourage exploration for oil, domestically and abroad, would put the company at a competitive disadvantage with other oil companies, and would penalize the Parent Company for its form of corporate organization. Cities Service claims that the staff's consolidated effective tax rate is a clear deprivation of property without due process of law, because it takes the benefits of the large tax deductions from the non-jurisdictional companies and passes them along to the gas customers in the form of rate reductions.

In his decision issued April 23, 1962, the Examiner agrees with Cities Service. He holds that the staff's position is basically wrong because it would thwart the true congressional intent of the tax law permitting the filing of a consolidated return, which was to encourage holding companies to expand their overall businesses for the betterment of the national and international economy. He cannot see the justice of permitting Gas Company's customers to receive what he considers a windfall from losses occurring in businesses unrelated to that of the regulated natural gas company merely because Gas Company and the corporations having the losses happen to have a common corporate owner. The Examiner adds that the regulated businesses should not have the right to take away from the non-regulated entity any part of the losses it utilizes for tax purposes. The Examiner thinks that, if driven to it, the Parent Company could rearrange its system of corporations in such manner as to eliminate tax losses, and there would then be no tax saving to allot to the gain companies, including Gas Company. Exceptions were filed by the staff and a

large Municipal Group[3] which had intervened and the issue is before us for decision:

The authorities do not give us a clear answer to the question of whether the tax allowance for the regulated company should take into account the losses of affiliates. Some authorities appear to support the "actual taxes" concept as advanced here by the staff. *City of Pittsburgh* v. *Pennsylvania PUC*, 128 A. 2d 372, 385-387 (Pa. Super. Ct. 1956); Re *New Jersey Power & Light Co.*, 9 N.J. 498, 89 A. 2d 26, 41 (1952). Other authorities eliminate the losses of affiliated companies or of separable operations of the same company. *Southern Union Gas Co.* v. *New Mexico PSC*, No. 31074 (D. Santa Fe County, June 9, 1961); Rates and Rate Structure, 29 PUR (N.S.) 391, 481-482 (N. Y. P.S.C., 1938).

The starting point in resolving the consolidated tax issue is the amount of the consolidated tax payment. This is the only real cost which was incurred by Gas Company in conjunction with the other Cities Service affiliates. The task is then to determine the proportion of the consolidated tax which is reasonably attributable to the Gas Company *vis-a-vis* the other Cities Service affiliates. The basic error in the position of Cities Service is that it ignores this point and claims an amount of Federal income taxes in Gas Company's cost of service on the basis of a hypothetical figure which Gas Company would have paid if it were a separate company. The simple truth of the matter is that Gas Company paid no separate Federal income tax but participated

[3] Consisting of the Kansas Cities of Altamont, Atchison, Chanute, Cherryvale, Downs, Erie, Gerard, Grenola, Howard, Iola, Melvern, Meriden, Osage City, and Perry; the Missouri Cities of Carl Junction, Carrollton, Carthage, Clinton, Independence, Joplin, Kansas City, Marshall, Neosho, Nevada, Oronogo, Pierce, Platte City, Springfield, St. Joseph, Waverly and Webb City; and City Utilities of Springfield, Missouri.

in the filing of a consolidated return with the other Cities Service affiliates. To accept Cities Service's position would be to approve fixing of jurisdictional rates on the basis of converting a hypothetical tax payment into a prudent operating expense. In effect, Cities Service argues that Gas Company ratepayers should make Cities Service stockholders whole for the tax losses of nonregulated enterprises even though this means an allowance for taxes over and beyond that which the consolidated system as a whole actually paid. We reject this view as neither just nor reasonable. Tax allowances in a cost of service are for the purpose of permitting the regulated entity to secure a rate which, after taxes, will provide a reasonable return on jurisdictional investment, not to insure that other components of a complex corporate system are enabled to "cash-in" on their tax losses.

However, we agree with Cities Service that the fundamental rate making principle governing our disposition of this issue requires a separation between regulated and unregulated costs and revenues. This principle controls our allocation of other costs which are jointly incurred by regulated and unregulated companies, or departments within the same company, and is controlling here.[4] If we were to allocate the consolidated system tax return among all profit companies including those in whole or part engaged in unregulated activities, there would be no sound reason for refusing to fix jurisdictional rates at a level sufficient to make up any real losses these companies might suffer.

Staff's approach possesses a quality of artificiality and instability which renders it unsatisfactory for ratemaking purposes. In effect, staff's effective tax rate is derived by

[4] As shown above, this principle is inconsistent with Cities Service's position that Gas Company's tax allowance should be computed as if it were a separate company.

taking the ratio Gas Company's income bears to the total income of the profit making companies, and applying this percentage to the system tax paid. It would be easy for Cities Service to escape from this onerous assessment by rearranging affiliates, mergers or intrasystem pricing arrangements in order to eliminate all or most of the other profit entities and thus increase the effective tax rate of the Gas Company. Significantly, the record shows that Cities Service could accomplish this result.

There are three preliminary matters to resolve before computing Gas Company's tax allowance according to the principles stated above. First, we must decide the period of time to be used in the computation. The Parent Company paid no federal income tax for 1958, the test year. If this test period were representative, we would include no tax allowance in Gas Company's cost of service. However, the tax liability of a complex such as Cities Service for a single year is not apt to be representative. As stated above, the record shows extensive tax data for each of the companies of the Cities Service system for the years 1957 through 1959. While data for a longer period of time might be useful for normalization purposes, in our opinion the detailed data for this three year period of time is sufficient to determine the tax rate applicable to Gas Company.[5]

A second preliminary matter requires us to compute taxable income by normalizing deductions for accelerated amortization and liberalized depreciation, consistent with

[5] We recognize that the record contains limited information for earlier years, i.e., 1954 through 1956. However, the information for the earlier years in this case is not sufficiently detailed to be used in computing the tax allowance for Gas Company in the manner determined appropriate herein; and to the extent that it indicated a different profit and loss picture may have obtained earlier, the subsequent history of Cities Service indicates that such earlier periods could not be considered as representative for rate making purposes.

our treatment in *Alabama-Tennessee Natural Gas Company*, 27 F.P.C. 1180. This is done in Appendix A. However, here as in other rate cases following *Alabama-Tennessee*, the Order herein will be made dependent upon our determination in that proceeding regarding the propriety of normalization for rate making purposes. In the event the so called flow through approach is adopted, the rates herein approved on a tentative basis will be appropriately modified.

The third problem is that there are certain compaines in the Cities Service system a portion of whose business is subject to regulation. The taxable income of these companies should first be allocated into regulated and nonregulated categories. Cities Service, however, has failed to present any evidence upon which to make such an allocation. We can, however, make an appropriate allocation of the taxable income of Cities Service Oil Company, (which represents nearly 99% of the total taxable income of the mixed companies, i.e., those companies having both regulated and nonregulated income), by taking official notice of certain evidence presented in the Oil Company's rate case in Docket No. G-9519, et al. This evidence (taken directly from the Oil Company's own books), shows that 6.28% of Oil Company's gross investment in net plant is devoted to regulated activities (production of natural gas).[6] The data relative to the production of casinghead gas is not included in this figure. Inasmuch as casinghead gas represents 13.51 percent of Oil Company's gas revenues,[7] we will adjust the 6.28 percent figure to take this additional investment into account. Applying the resulting

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[6] Dockets No. G-9510, et al., Exhibit 38, Schedule 3.
[7] IBID, Exhibit 35, Schedule 3, Sheet 3.

7.13 percent[8] to Oil Company's total taxable income of $51,252,182 produces regulated income for Oil Company of $3,654,281.[9] A similar allocation with respect to Cities Service Production Company results in 24.16 percent or $6,464,235 of that Company's tax losses attributable to regulated activities.[10]

Having made these adjustments, we can now allocate the tax cost of the Cities Service system between regulated and nonregulated companies. For the three year period under consideration, the nonregulated affiliates, including nonregulated income of Oil Company, had no taxable income. In fact, the record shows they had a substantial tax loss. It is therefore inappropriate to assign any tax liability to this group of companies. Accordingly, we conclude that the actual tax paid by the Cities Service system, as normalized, is reasonably allocable among the regulated companies.

In sum, the proper method to be applied in computing the Federal income taxes to be included in the cost of service of a regulated company where that company has joined in a consolidated tax return with affiliates is (1) separate the companies into regulated and unregulated groups, (2)

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[8] This figure was obtained by multiplying $29,775,181 (investment in gas plant excluding casinghead) by 1.1351. The resulting figure of $33,797,808 is divided by total plant investment of $473,788,545 which produces 7.13%.

[9] We wish to make it clear that a simple manner of allocating the taxable income of mixed companies should be used in any future cases involving this issue. Obviously, it is administratively infeasible to compute a detailed cost of service for large integrated corporations to determine one element of a regulated company's cost of service.

[10] $12,970,608 or 17.46 percent of Production Company's average net investment of $14,276,476 relates to gas production, exclusive of casinghead gas. Casinghead gas represents 38.34 percent of the Company's gas revenues, and the 17.46 percent figure adjusted to take this further investment into account produces 24.16 percent. (Docket No. G-9510, Exhibit 32, Schedule 2, Sheet 1, and Exhibit 35, Schedule 2, Sheet 2).

determine the net aggregate taxable income of each group, and (3) apportion the net total consolidated tax liability over a representative period of time between the two groups, and among the companies in the regulated group, on the basis of their respective taxable incomes; provided that the allowance so computed for the regulated company shall not exceed what its tax liability would be for rate making purposes, if computed on a separate return basis.

The computation of Gas Company's tax allowance is computed in Appendix B. As this Appendix shows, we based this computation on the ratio Gas Company's taxable income bears to the total taxable income of the regulated group. This, of course, is similar to staff's approach which we consider reasonable when the nonregulated affiliates have been excluded.

The Commission further finds:

(1) Gas Company's proper tax allowance is $5,866,847.

(2) The rates filed by Gas Company filed pursuant to the Settlement Agreement and our order of March 27, 1961, subject to the reservation of the tax issue are excessive and should be disallowed.

(3) Gas Company should file tariff sheets and make refunds in accordance with this opinion.

The Commission orders:

(A) The rates filed by Gas Company pursuant to the Settlement Agreement and our order of March 27, 1961, are hereby disallowed.

(B) Gas Company shall, within 45 days of the date of this order, file appropriate substitute tariff sheets to its FPC Gas Tariffs except for Rate Schedules I-1 and I-2 containing rates satisfactory to the Commission based on

a tax allowance of $5,866,847 for the test year, found to be appropriate in this opinion and order. Gas Company shall accompany its rate filing with supporting cost of service and allocation data persented in the same form and manner as that contained in the exhibits attached to the stipulation approved in our order of March 27, 1961, revised only to reflect the change in the allowance for federal income taxes. Gas Company shall further furnish with its filing a statement setting forth the method of computation of such rates and showing the derivation thereof. Gas Company shall also accompany its tariff sheets and supporting data with a certificate showing service of copies thereof on all purchasers under the rate schedules involved, interveners in this proceeding, and interested state commissions. Comments by such parties shall be submitted to the Commission within ten days after service by Gas Company as required herein.

(C) Upon acceptance by the Commission of the tariff sheets filed by Gas Company pursuant to paragraph (B) above, the rates, charges and classifications set forth therein shall become effective for the period November 23, 1959, through December 22, 1961.

(D) Gas Company shall, within 70 days of the date of this order, file with the Commission a statement showing the distribution to its jurisdictional customers of appropriate amounts to be refunded with interest at 6 percent. With respect to Rate Schedules F-1, F-2, C-1, C-2, E, P and X-5 the refund shall represent the differences between (1) the amounts collected under rates charged in accordance with the stipulation of October 21, 1960, and our order of March 27, 1961, and (2) the amounts that would have been collected under the rates filed pursuant to this opinion and order, from November 23, 1959, to December 22, 1961, with interest at 6 percent. With respect to Rate

Schedules I-1 and I-2 the refund shall, in accordance with the stipulation, represent an amount equal to 50 percent of the difference between (1) the sum that would have been payable under I-1 and I-2 Rate Schedules made effective February 23, 1961, for natural gas purchased from Gas Company during the period from June 23, 1959, through July 22, 1961, and (2) the charges which would have been payable for such service during the same period if I-1 and I-2 rates reflecting the Commission's determination of the reserved tax issue had been in effect.

(E) Gas Company shall accompany its statement of refunds with a computation of the refunds and interest, and the derivation thereof, and with a certificate showing service of copies thereof on all purchasers under the rate schedules involved, interveners in this proceeding, and interested state commissions. Comments by such parties shall be submitted to the Commission within ten days after service by Gas Company as required herein.

(F) Within 10 days of the approval of the statements of refunds by the Commission, Gas Company shall make the required refunds so computed and within 15 days thereafter shall report to the Commission in writing and under oath the amount of refund made to each of its customers, showing separately the amount of principal and interest so paid and shall serve a copy of such report upon each of the customers receiving a refund. Concurrently therewith, Gas Company shall file with respect to such refunds, releases from its jurisdictional customers showing receipt of the principal and interest in conformity with this opinion and order.

(G) As provided in the Settlement Agreement approved by our order of March 27, 1961, Gas Company shall file further rate reductions and make further refunds as a result

of refunds to it by its suppliers or a reduction in its cost of purchased gas.

(H) The rates required to be filed herein are specifically subject to such further adjustment as may be required as a result of the application of a final decision by the Commission in *Alabama-Tennessee Natural Gas Co.*, Docket No. G-5471, *et al.*,* on the treatment of deferred federal income taxes to the computation of the tax allowance made herein but only from and after the date of such decision or a later date if specified by the Commission therein.

(I) Exceptions not granted herein are hereby denied.

Commissioner Morgan *concurring*, filed a separate statement appended hereto.

Commissioner Woodward *dissenting*, joined by Commissioner O'Connor, filed a separate statement appended hereto.

/s/ J. H. Gutride
Joseph H. Gutride,
Secretary.

* [Issued February 2, 1964, 31 FPC 208]

Docket No. G-18799 **Appendix A**

CITIES SERVICE GAS COMPANY

Normalization of Cities Service Consolidated Tax

Particulars	Calendar Year 1957	1958	1959	Total
(1)	(2)	(3)	(4)	(5)
Calculation of Tax on Consolidated Basis Using Straight Line Depreciation				
Consolidated Taxable Income (Form 1120)	$23,637,088	($7,145,571)	$ 7,003,440	$23,494,957
Add: Excess of liberalized depreciation and accelerated amortization over straight line	9,147,913	10,245,432	9,153,089	28,546,434
Subtotal	32,785,001	3,099,861	16,156,529	52,041,391
Deduct: Long-term gain	(808,323)	(2,248,731)	(2,486,203)	(5,543,257)
Income subject to 54%	(18,073,798)	—	—	(18,073,798)
Balance taxable at 52%	13,902,880	851,130	13,670,326	28,424,336
52% of utility income normalized	7,229,498	442,588	7,108,570	14,780,656
54% of non utility income normalized	9,759,851	—	—	9,759,851
25% of capital gains	202,081	562,183	621,551	1,385,815
Total	17,191,430	1,004,771	7,730,121	25,926,322
Less surtax exemption	5,500	5,500	5,500	16,500
Tax assuming straight line depreciation	$17,185,930	$ 999,271	$ 7,724,621	$25,909,822

Docket No. G-18799 Appendix B

CITIES SERVICE GAS COMPANY
COMPUTATION OF GAS COMPANY F.I.T.

Income (Normalized)	1957	1958	1959	Total
Cities Service Gas Company	$11,280,832	$12,256,412	$18,340,470	$41,877,714
Cities Service Gas Producing	2,158,402	2,085,416	2,183,609	6,427,427
Cities Service Pipe Line Co.	2,622,047	2,686,669	3,093,433	8,302,149
Lafitte Oil Traders, Inc.	22,562	125,455	275,155	423,172
Kansas Gas Supply Company	215,128	339,359	313,433	867,919
Cities Service Oil Co. — Del. (Regulated Portion)	1,499,006	1,259,798	895,477	3,654,281
				61,652,662
% of Cities Service Gas Co. to Total regulated companies*				67.93%
Consolidated Tax Allowance for Years 1957-1959 (Appendix A)				25,909,822
Average Consolidated Tax Allowance ($25,909,822 ÷ 3 years)				8,636,607
Tax Allowance for Cities Service Gas Co. (67.93% x $8,636,607)				$ 5,866,847

* No portion of the consolidated tax is allowable to Cities Service Production Company because that Company had no taxable income.

MORGAN, Commissioner, *concurring:*

On the basis of the record before us it appears that, by virtue of filing a consolidated Federal income tax return for the years 1957 through 1959, the Cities Service System companies collectively enjoyed a Federal income tax saving in the order of some $48 million.

It also appears from the record before us that with few exceptions, one of which is discussed below, the parent company allocated this enormous saving among the mem-

bers of its corporate family on the proportionate basis of the taxable income each of them produced. This appears eminently fair, and this, moreover, is the method the tax regulations suggest for distributing these savings among the corporate family.

It is the "few exceptions" that concern us — most particularly, the Cities Service Gas Company. We are concerned with this "exception," first because that company sells a commodity vested with a public interest, at rates having the force of law, to consumers whose ratepaying welfare we are charged by Congress with protecting; second, because on the basis of allocating this saving which parent has chosen for its *unregulated* companies (that is, in proportion to taxable income), this particular public utility *should have* enjoyed savings of about $17.7 million during the period mentioned; third, because utility regulation traditionally and without detectable exception has always required savings in utility tax costs to flow through in the form of reduced rates to the consumers who alone and by law must bear the utility's entire tax burden; and fourth, because the parent in this case has refused to apportion, distribute, allocate or grant a single penny of the entire tax saving to the public utility that has been placed under what should be the watchful eye of the Federal Power Commission.

The vociferous legalisms and cries of outrage that the company has raised as a result of staff's suggestion that this utility, like its sister affiliates, should share fairly, equitably, and proportionately in the tax saving in question — a tax saving made possible in large part by the utility's taxable income — have created a large and to some degree confusing record here.

But the company's cries of outrage are no more heartfelt than the cries and suggestions of "outrage," "fraud,"

"fictitious," "dishonest," "indefensible," "sinful" and other expletives that were uttered in the United States Senate and House of Representatives when, despite the same defenses offered there as here, the details of the selfsame practices by the selfsame company were made known to the Congress during its consideration of the bill that became the Public Utility Holding Company Act of 1935.[1]

The practice was not then and there outlawed because — and it is safe to say *only* because — that very practice had been forbidden for any and all corporations, except

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[1] Specifically, see pages 477-482 of Volume 72A, "Utility Corporations," setting forth the results of certain financial practices uncovered in the course of the Federal Trade Commission's massive investigation in this utility area from 1928 to 1935; see the hearings on the bill before the House Commerce Committee at pages 153-155; Senate hearings at pages 234-255 and 514; the debate on the bill in the Senate at 79 Cong. Rec. 8392 and 8525-26; and in the House at 10323.

The comment of Senator Norris was typical:

> "Practically all the systems I have shown on the various charts, together with others not shown, made what the law formerly permitted — that is, returns for taxation purposes on a consolidated basis — resulting in a great saving of taxes to the holding-company groups, although, as a matter of fact, operating groups as a rule were subject to a tax. However, the holding companies, taking advantage of the law permitting consolidated returns, collected the taxes from their operating companies, and then, by setting off losses sustained by some of the operating companies, it was possible in this way to retain these taxes by balancing losses of some operating companies against profits of other operating companies. Thus it has often happened that operating companies have paid taxes which ordinarily would have been due the Federal Government, and the holding companies by balancing off losses from other operating companies paid no tax to the Federal Government, but retained the money the operating company had paid as taxes. So some operating companies actually paid their taxes, expecting the money to go to the Federal Government through the holding companies, but by the process I have just described the holding companies kept the taxes and paid nothing to the Federal Government. If anybody can square that with honesty, I should like to have him do it."

railroads owning 95% of their operating subsidiaries, by the Revenue Act of 1934. But, with the imposition of the wartime excess profits tax, Congress by the Revenue Act of 1942 allowed the practice to be resumed. The matter is now before us, a Federal public utility commission, for disposition in the light of the basic tenets of the public utility law we are charged with administering.

If this were a matter of tax law, as company and the dissenting opinion would have us treat it, we, like the Internal Revenue Service, would only be interested in checking the accuracy of company's arithmetic. But this is a rate proceeding, not a tax audit. The problem here is only the problem of determining how the utility's share of the system's actual tax liability should be determined; or the extent to which a regulated utility's tax and rate-paying consumers should realize or be deprived of a saving in tax charges which in utility law are imposed upon and chargeable exclusively to utility ratepayers.[2]

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[2] Consolidating the income of several wholly-owned corporations for the purpose of determining system income is especially appropriate in the case of public utillity systems, because management often chooses to organize those systems into a series of separate corporations to facilitate doing business in each of the states in which the utility system operates. This is the reason used to justify the use of the consolidated return by utilities before Congress; and this also is the reason Congress removed the 2% penalty tax for public utilities that file consolidated returns (see House Ways and Means and Senate Finance Committee hearings on H. R. 8400 in the 84th Congress, the bill that became the Internal Revenue Code of 1954). And in removing that penalty tax, as well as in making the privilege of filing consolidated returns available to public utilities as well as to other taxpayers, Congress was aware that from the time of the Supreme Court's opinion in the Galveston case, 258 U.S. 388, (1922) if not earlier, where the law of public utility regulation operates it requires utility consumers to pay the full amount, but not more than the full amount, of the utility's actual tax liability, or its allocated share of the system's actual tax liability.

The difficulty is not in determining whether this utility's share of the tax saving should benefit the consumers who pay its taxes: the difficulty is in estimating this utility's proper share of the saving. Many methods for allocating that saving or estimating the utility's share thereof have been explored, but each has been found wanting by my colleagues. Speaking for myself, I must say that the method used by Cities Service for allocating its total tax liability and tax saving among *some* of its subsidiaries, and by the staff for allocating that total liability and saving among *all* of Cities Services' subsidiaries, is the most logical method and the one which best meets the standards and requirements of utility regulation. Further, it alone of all methods considered here is the one which reflects those vigorous expressions of Congressional intent in this particular matter which should guide the exercise of our discretion.

Briefly, the facts in this case relating to the three-year period under review are these: The system of which Gas company is a part consists of 37 separate corporations, about 6 of which are regulated; and the tax losses of some of the system's companies reduce the taxable profits of its regulated and unregulated companies and thereby reduce the system's over-all actual tax liability. The amount of the system's actual liability — or its tax saving (i.e., the difference between the total tax that would have been paid if each company in the system had been taxed separately, and the tax actually paid on the profits of those companies as reduced by the losses of the other companies) — properly should be distributed or apportioned over the system's profit companies on the basis of the separate taxable income each profit company had; and the record before us is totally barren of any sensible reason for differentiating between regulated and unregulated companies. At least it is barren of any reason which will stand scrutiny in the light of the public interest.

Here the total profits of the system's profit companies for the three year period were $123.4 million; other system companies had tax losses totalling $100 million; taxable system income thus was $23.4 million; and consolidated system tax liability for the three-year period was $11.4 million. The tax saving thus realized was the difference between the $63.2 million that the profit-making companies would have paid if they had been taxed separately, and the $11.4 million that the system actually paid, or (excluding a $4 million refund in 1958 of 1955 taxes) roughly $48 million.

Taxable profits of Gas company alone were $42 million; and it would have paid a tax of about $22 million *if* it had been taxed separately.

If the system's over-all tax liability or tax saving had been distributed among the profit companies proportionately on the basis of their separate taxable incomes, since Gas company's $42 million of taxable income was about 35% of total system taxable income ($123.4 million), Gas company should bear about 35% (or $4 million) of the system's actual $11.4 million tax liability; and should benefit by about 35% (or $17 million) of the system's $48 million tax saving.

But Gas company did not charge its consumers $4 million for taxes. It charged them the $22 million Gas company would have had to pay *if* it had been taxed separately. Gas company turned over the $17 million saving to the parent company, which, the record shows, used these funds to subsidize its non-regulated activities.[3]

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[3] We are only concerned with Gas company's $17 million share of the system's $48 million tax saving, because that $17 million was actually paid in cash by Gas company's consumers who pay its "taxes." We are not concerned with the other $31 million. To the extent it is attributable to the system's unregulated companies, it belongs to the stockholders and management who must see that the taxes of those companies are paid.

Gas company says this is all right. It says it really did have a "tax" bill of $22 million, because the parent company on its books did not allocate any of the system's $48 million tax saving to Gas Company. The parent company purposefully assumed that its tax losses wiped out the taxable income of its unregulated companies (only), and that the whole 37-company system's tax liability was chargeable to the regulated companies alone. The result of this "allocation theory" — to use a very dignified term — is that Gas company's consumers were charged an amount for "taxes" that was larger than the actual tax liability of the entire 37-company system.[4] Moreover, Gas company did not reduce its "tax" charge to its consumers even in years when the amount of system tax loss was so large that, after wiping out all unregulated company profits, it *should have* reduced Gas company's separately computed "tax" charge. The parent company did not give Gas company's consumers the benefit of Gas company's share of the tax savings as computed, *even under its own arbitrary allocation method.* The position of Cities Service company is that none of the system's tax savings should be used to reduce Gas company's hypothetical "tax" charges to its consumers, because those consumers did not finance the tax losses that gave rise to those savings. But, as we shall see, that is exactly what the consumers did, although involuntarily.

This entire practice is in complete conflict with the established principle that because a utility's consumers alone must pay its entire tax bill under rates having the force of law, a utility cannot charge its consumers more for taxes than the actual amount, estimated where necessary, that the utility actually paid or contributed to the U.S. Treasury,

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[4] During the three-year period in question, although total system actual tax liability was (only) $11.4 million, Gas company's consumers were charged $22 million for "taxes."

or more than the utility's *proper and equitable share* of the system tax actually paid. In the utility field, stockholders are entitled to a fair, constitutional rate of return, and the tax thereon is paid by utility consumers so that the fair return will not be reduced by taxes. Once the utility or its stockholders have received that return, they may not obtain more by claiming higher, fictitious, or hypothetical costs they might have incurred if they had been organized or operated in some other, *unreal* manner. To allow additional return — over and above a fair return as defined by the courts — is to countenance unjust enrichment of the utility or its owners at the expense of the ratepayer.

My colleagues, perhaps unwilling to chart clear regulatory policy amid the consolidated tax legalisms raised herein, prefer (a) to separate the system's business into its regulated and unregulated portions; (b) to apply all of the system's tax losses (which normally stem from some of its unregulated activities) to reduce the profits or tax liability of its unregulated profit companies first, and then (c) to use whatever loss deductions may remain to reduce the liability that the utility or utilities would have had if they were separately taxed. This, it will be noted, gives the priority of use of the system's tax loss benefits primarily or even entirely to its unregulated profit companies.[5]

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[5] On the basis of Gas company's average "tax" charged during the three-year test period used herein, Gas company here claimed an average annual "tax" allowance of $7,055,981; on the basis of an allocation of the system's average actual tax during that period, staff claimed, properly, in my opinion, that Gas company should receive a tax allowance of $789,082; the majority opinion herein (after normalizing tax deductions for liberalized depreciation and accelerated amortization and making other refinements) grants Gas company $5,866,847. This is not regulation at its best. My reasons for accepting this result are set forth hereinafter.

In passing, it may be noted that if this policy is equitable and if "turn about is fair play," the priority could and perhaps should be reversed for regulatory purposes. That is, if preference is to be given either group of subsidiaries, regulatory authority might properly apply the tax loss benefits first to wipe out the tax liability of the *regulated* subsidiaries (which almost invariably operate at a taxable profit), and then to use whatever loss deductions may remain to reduce the tax liability that the *unregulated* subsidiaries would have had if their taxes had been separately computed. This would not alter the system's overall tax liability. But it would produce significantly larger tax reductions for the regulated companies, which would eventually be translated by regulatory authority into reduced rates and gross revenues. It would likewise greatly reduce the expendable funds, generated in the guise of "taxes" paid by utility ratepayers, which the parent company now disburses across the face of the earth to operate the speculative ventures of its various non-regulated corporations.[6] It is these specific corporate operations, *in large part financed and underwritten by "taxes" extracted from ratepayers,* which give rise to the tax loss benefits which the parent company claims it has the *exclusive* right to enjoy on the ground that the ratepayers had nothing to do with them!

It naturally follows that reversal of the priorities herein approved would produce another barrage of legalisms and redoubled screams of rage and pain from the parent company. The reader, whether he is a judge, a corporate lawyer or a utility ratepayer, can reach his own conclusions as

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[6] That the great bulk of these far-flung speculative enterprises are of no benefit or advantage to consumers who are served by Gas company — and who pay its "taxes" — is made abundantly clear by the majority opinion in the second paragraph thereof.

to the validity of such protests. For if he has followed the discussion this far he can see clearly what has been happening and he knows exactly to whom it has been happening.

In any event, it is clear that the policy adopted here gives priority and favored treatment to the non-regulated companies rather than to those whose rates are subject to regulatory control by this and other commissions. I should have preferred that no priority or favored treatment be given to either group; and, speaking only for myself, I therefore believe that the actual tax and actual tax allocation method here urged by the staff is the preferred solution to this problem.

Most reluctantly, however, and solely for the purpose of enabling a decision to be reached in this case, I concur in the policy adopted by my colleagues of the majority. Though far from perfect, it is a discernible improvement over the situation that has existed here and in numerous other corporate families for many years. The approach of the majority, which is more in the nature of an assignment than an allocation, will serve at least to limit the tax liability of Gas company's ratepayers to the actual liability of the entire system as a whole. It at least will prevent them from having to pay a tax charge that is *larger* than the actual liability of the entire system of which Gas company is a minor part.[7] This is no small matter, for Gas company's lawyers have been unable to obscure the fact that in 1958, when the tax liability of the total system was zero, the parent company nevertheless imposed a "tax" charge upon the ratepayers of the regulated utility in the amount of $6,367,534, not one penny of which was paid to the Federal Treasury.

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[7] Gas company's jurisdictional revenues represent about 5% of the system's gross revenues.

In sum, this method of apportioning the tax saving and tax burden has the limited virtue of accommodating, to a very small and unsatisfactory degree, the two irreconcilable concepts at war with one another here. That is, it permits company and stockholder to enjoy an overly generous portion of the benefits which they erroneously claim are entirely theirs by virtue of the tax law alone; and it goes some small way toward producing a more equitable charge to ratepayers for the estimated amount of tax liability actually incurred by or attributable to the regulated utility that serves them.

I should have preferred that we face our responsibilities squarely and discharge them fully. Regrettably, that is not possible; and without my concurrence the little that has been accomplished herein will be lost. It is only on that account that I concur in the result reached by my colleagues of the majority.

/s/ HOWARD MORGAN, Commissioner
Howard Morgan, Commissioner

WOODWARD, Commissioner, joined by
O'CONNOR, JR., Commissioner, *dissenting*:

This is a major rate case in which the Commission must decide a fundamental and critical question. While the Commission, in the past, has properly insisted that certain tax advantages to be obtained from filing a consolidated return for groups composed entirely, or predominantly, of regulated companies, be passed on to consumers, it has not held that business losses of unregulated and unrelated corporations participating in a consolidated return should be uti-

lized for the benefit of the consumers of a regulated natural gas company. The latter issue is before us for the first time.

The majority concludes that the proper method to be applied in computing the Federal income taxes to be included in the cost of service of a regulated company where that company has joined in a consolidated tax return with affiliates is (1) separate the companies into regulated and unregulated groups, (2) determine the net aggregate taxable income of each group, and (3) apportion the net total consolidated tax liability over a representative period of time between the two groups, and among the companies in the regulated group on the basis of their respective taxable incomes. If each of the resulting groups shows a net taxable income, this formula would fairly allocate the total tax in accordance with the respective amounts of taxable income. But where, as here, the unregulated group has a net loss for the test period, the formula appropriates that loss which was the result of expenses and losses financed by the stockholders and deducts it from the tax allowance to be charged the ratepayers, thereby granting to them the entire benefit emanating from the tax loss. As applied here, the $2.4 million net taxable loss of the unregulated group is handed over to the ratepayers by deducting it from the taxable income of Gas Company, thereby reducing its tax allowance by $1.2 million.

The Opinion and Order adopted by the majority is based on the false premise that, as to industries regulated by it, the Commission has the authority to limit the effect of a mandate of Congress as expressed in Section 1501 of the Internal Revenue Code. Depriving Gas Company of a tax allowance which would be routinely granted to it by the Commission if it were not for its having a common owner with an unregulated and unrelated petroleum business, should not be done without some very persuasive reasons

based upon sound rate-making policies which impose no confiscatory rates, which balance equitably consumer and investor interests and which take fully into consideration the impact of such action upon national economic policies. At the root of regulation is economic policy. The problem of economic growth in the United States is crucially important and inseparably related to economic growth is investment. Under the majority view, the consolidated return would not result in stimulating investment and growth because it has the effect of converting non-jurisdictional losses within the parent company's system into a rate reduction for gas consumers. The majority opinion is not supported by persuasive reasons based on sound policy.

Since this Commission possesses only the legislative powers which the Congress has granted to us, clearly we have no power to amend Section 1501 of the Code. Apart from the fact that there are no tax savings attributable to the inclusion of Gas Company in the consolidated return, the majority view is unlawful because it has the effect of regulating non-utility enterprises beyond the Commission's jurisdiction; it would strip the parent company of congressionally-conferred rights to tax deductions of its non-jurisdictional subsidiaries. The Majority is in error and I dissent.

The Cities Service system is operated principally as an integrated petroleum operation. The jurisdictional revenues of Cities Service Gas Company, a wholly owned subsidiary of Cities Service Company, comprised approximately 4.88%, 5.14% and 6.16% of the total system revenues in 1957, 1958, and 1959 respectively. Only 3% of the gross revenues of two other companies in the system are subject to Commission jurisdiction.[1]

[1] Cities Service Production Company and Cities Service Oil Company (Delaware).

In this proceeding, the Commission is to determine the proper Federal income tax allowance to be included in the cost of service of Gas Company, one of 37 subsidiaries joining the parent company in the filing of a consolidated return.[2]

Chapter 6 of the Internal Revenue Code, "Consolidated Returns," Section 1501, "Privilege to File Consolidated Returns" gives to "an affiliated group of corporations the privilege of making a consolidated return with respect to the income tax imposed" on corporations of which the parent company owns 80% or more of the outstanding stock. When corporations join in such returns, the Code, Section 1503, levies an additional 2% tax upon all includable taxable income except that of utilities such as Gas Company whose tax rate remains at the statutory rate of 52%.

The precise intent of Congress in granting the privilege of the consolidated return to an affiliated group of corporations was to encourage companies to expand their overall businesses for the betterment of the national and international economy and to eliminate any tax disadvantages of doing such through subsidiaries.

The parent company here owns, directly or indirectly, 100% of the stock of every corporation which participates

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[2] Consolidated returns are based on the principle of levying a tax on the true income of a single enterprise even though the business is operated through more than one corporation.

The primary advantages of filing a consolidated return may be summarized as follows:

(1) The offsetting of operating losses of one company against the profits of another.

(2) The consummation of inter-company transactions without the recognition of income.

(3) The designation of the parent company as agent of the group for all tax purposes.

in the filing of its consolidated return. As such stockholder its own 100% of the assets of each corporation, and it is entitled to 100% of all net income of each, subject to income tax levies. Also, as the sole stockholder, it bears 100% of every risk, expense and loss sustained by its subsidiaries. These expenses and losses should not be appropriated for the consumers of a regulated natural gas company who bore no part of them, assumed no risks in relation to them, and have no right to use them to reduce their gas costs.

The parent's conducting of its petroleum business through many subsidiaries is a matter of lawful choice and the permission given by the Internal Revenue Code for the filing of one consolidated return by qualified affiliated subsidiaries recognizes such lawfulness. Gas Company performs no activity or function in relation to the parent company's primary business of conducting its petroleum operations. Gas Company is a regulated natural gas company transporting and selling natural gas for resale in interstate commerce and it is operated as such entirely separately from the petroleum operations of the parent company. *Whether one of the included corporations has a taxable gain or loss is determined from its individual tax return calculated separately. It is in the separate return where all lawful expenses of operation are deducted to determine whether there is income of the individual corporation subject to tax.* (emphasis supplied)*

The examiner clearly determined, on the basis of record, that no part of the cost of producing the revenues of the petroleum business contributes in any way to produce Gas Company's revenues. No part of Gas Company's costs, including its income tax allowance, contrib-

* [I.e., by Commissioner Woodward.]

utes in any way to producing revenues to the petroleum entity. No part of any loss of any subsidiary corporation in the petroleum business, operated as an entity, is reflected in Gas Company's agreed cost of service. The net taxable income of Gas Company gave rise to no tax savings by the parent; the parent, in effect, see p. 174 [32-3c] *infra*, paid the full 52% statutory rate on the taxable income of the Gas Company.

I see no justification for crediting the Gas Company with part of the losses, thereby reducing its allowance for income taxes. To do so would result in a windfall to the Gas Company's customers and would deprive the parent of tax deductions to which it is lawfully entitled. Stated simply, the tax savings were the result of non-jurisdictional operations and were not financed by Gas Company nor in any way made possible by the inclusion of the Gas Company in the consolidated tax return group. Most assuredly, Gas Company is not entitled to tax savings arising out of foreign and domestic exploration, production, refineries, gas station operations, petrochemical, tanker and other non-jurisdictional operations. The majority view would inflict harmful consequences on the unregulated subsidiaries which the Commission is without power to cure. Unlike the case when it regulates the Gas Company alone, the Commission lacks authority either to increase or decrease the prices which the non-utility subsidiaries charge for their petroleum products. Briefly, the majority proposal is a regulatory one way street.

As Examiner Kelly has correctly declared, "The Code does not contain the criteria for rate making in this case. Under the Code, one only considers whether the corporations involved are qualified to participate in the consolidated return, whether such qualified corporations have lawfully computed their respective tax labilities, what the con-

solidated tax should be, and whether all other tax laws or regulations have been met . . . The Commission determines the proper return to be allowed upon the rate base and the proper income tax allowance to make the return net to the investor, and no tax law or regulations should interfere with the performance of this function by the Commission . . . The Commission has the full right to examine all figures in such consolidated tax return, and to ascertain from what situations or circumstances they may have resulted. There considerations are demanded by the public interest. The public interest demands that a petroleum business receive, at the hands of the Commission, at least as much encouragement and incentive in the conduct of its exploration and development activities as the national policy particularly as expressed in the income tax laws, dictates."

The uncontroverted evidence of record conclusively establishes that for each of the test years selected, the inclusion of Gas Company added a cost to the consolidated return in an amount equal to 52% of Gas Company's taxable income. In 1957, the parent company paid a consolidated tax of $12,251,639 on the income of its subsidiaries of which $5,860,398 was attributable to and equal to 52% of Gas Company's taxable income. In 1958 the parent company received a tax refund of $6,367,534, but it would have received a total refund of $10,224,666 if Gas Company had not participated in the consolidated return. Thus, the parent company, in effect, paid a tax of $6,367,534, representing 52% of Gas Company's 1958 taxable income, by foregoing the additional refund in that amount. In 1959, the parent company paid a tax of $2,965,014, but it would have received a refund in the amount of $6,566,531, if Gas Company had not been included in the consolidated return. Thus, the parent, in effect, paid $9,531,545 in payment of the tax at the rate of 52% on Gas Company's taxable income. The record shows that Gas Company's taxable income was not necessary to produce tax savings in the test years.

There is no question that Gas Company would pay a 52% tax had it been considered on a separate basis. The parent, by including Gas Company in the consolidated return, added a cost thereto equal to 52% and allocated a 52% cost to the Gas Company. I fail to see where the inequity of such an allocation lies. The parent company obtains no tax or other advantage from including Gas Company in its consolidated return. Owning 100% of the stock of Gas Company, the law requires that it includes this subsidiary in its consolidated return. Gas Company, being a regulated monopoly with a practically assured net income each year, is not among the subsidiaries with losses to offset against the total net taxable income of all subsidiaries having such losses. Therefore, no tax saving whatever results to the parent company from the inclusion of Gas Company in the consolidated return.

The examiner noted further, "Any immediate but perhaps temporary tax saving accomplished by the filing of a consolidated return is not in any sense comparable to a real and permanent tax saving effected by taking a lawful deduction and passing on the benefit thereof to consumers. The tax saving effected by proper deductions is a definitely known and fixed saving for the tax year, which is certainly not true of any temporary saving effected through the offsetting of business losses against business gains. It is not the mere filing of the consolidated return but the fact of business losses having been sustained in the particular tax year which permit the temporary tax savings. The distinction must be acknowledged between the fixed and certain tax saving, and the temporary, uncertain and unascertained tax saving accomplished by utilizing business losses in a consolidated return. The latter should not be used to lower a tax allowance in a cost of service."

Completely ignoring the fact that Congress has provided that tax payers may lawfully use their tax losses to offset their taxable income in the manner provided by statute, the majority imparts its own preemptory economic and regulatory philosophy to strike down an act of Congress.

The majority cites no authority of the Commission or the Courts to sustain this onerous theory. This proceeding cannot be resolved on the basis of an imagined rationale which is in fact contradicted by the record or by the reciting of an appealing slogan. This is a clear deprivation of property without due process of law since the majority proposes to take away from the non-utility subsidiaries and the parent company valuable property rights which belong to those companies. The tax deductions given by Congress as incentives to non-utility investment should not be taken away in such manner. No company owes anyone a duty either moral or legal to incur, or to continue to incur, losses in non-jurisdictional business so that jurisdictional rates can be reduced. Following the theory of the majority, how can an integrated oil company, which also has a natural gas pipeline company within its corporate structure, compete on equal terms with an oil company not having similar pipeline operations, if the latter can use all of its tax savings in its oil business but the former cannot? Clearly, it cannot so compete.

I would reflect on a point that deserves serious consideration. All but three of the 37 corporations involved in this proceeding are, in some way, connected with the petroleum business operated by the parent company. Conceivably, the parent's business could be conducted by a departmentalized single corporate entity. If this be true, there would be no losses to offset against taxable income since the single corporation would show an overall profit although some of its departments would lose money. Under

such circumstances no consolidated return would be filed and the Commission would routinely grant to the Gas Company a tax allowance based on the statutory rate of 52%. In the instant proceeding, the majority places a penalty on the parent company because it has lawfully chosen to operate its world wide business through subsidiaries. Such a regulatory policy is unsound and inequitable.

The fact remains that Congress has given the parent company, not this Commission, the right to decide whether or not it will take advantage of the consolidated return and the benefits and obligations accruing thereunder. The Commission cannot interfere with this lawful decision of management so to conduct its business. The tax laws recognize this and they have given companies the opportunity to so operate without sustaining a tax loss because of their business activities. Congress did not commit management judgments to an administrative agency; this is the line past which a regulatory commission such as ours may not go.

If the economic advantage arising out of the filing of a consolidated tax return is to be passed on to Gas Company's ratepayers, which is the effect of the majority decision, the intent of Congress will be defeated. Here, the language of the statute is plain and unambiguous and it must be given effect according to its obvious meaning. By allowing the taxpayer the full advantage provided by the consolidated return, no attendant harm results to the ratepayers. This method does not result in higher rates to the consumer, it simply does not operate to reduce them. This view is in harmony with Section 1501 of the Internal Revenue Code, is fair to the ratepayer yet it does not constitute an expropriation of the constitutional powers of Congress.

The majority decision results in glaring defects and inequities; they have not offered any valid and compelling

reasons for their decision. Contrary to the views expressed by the majority, I believe every effort should be made to afford all legitimate and necessary incentives to private enterprise while, at the same time, protecting the consumer ratepayer.

The examiner who heard the testimony in this proceeding correctly concluded, upon the basis of the record evidence and the pertinent law and regulatory policy, that the Federal income tax allowance included in the cost of service supporting the settlement agreement approved by the Commission in its order of May 27, 1961, computed at the statutory rate of 52%, is not excessive or in any way improper, and should be approved. In my judgment, the examiner's decision should be affirmed.

/s/ Harold C. Woodward
Harold C. Woodward, Commissioner

/s/ L. J. O'Connor, Jr.
L. J. O'Connor, Jr., Commissioner

APPENDIX D

TAXABLE NET INCOME OF UNION PRODUCING COMPANY

Year	Taxable Net Income (1)	Gas Operations (Includes Both Jurisdictional and Non-Jurisdictional) (2)	Oil Operations (100% Non-Jurisdictional) (3)
1957	$(2,269,975)	$(1,486,211)	$ (783,764)
1958	4,852,736	3,430,415	1,422,321
1959	(1,958,398)	(461,366)	(1,497,032)
1960	(4,333,704)	(1,436,232)	(2,897,472)
1961	(160,285)	460,648	(620,933)
5 Year Total	$(3,869,626)	$ 507,254	$(4,376,880)

Source:

Col. (1) — Ex. 36 (Revised) (R II 24)

Col. (2) — Ex. 14-1, Sch. 2, line 12, Col. 4 (R II 6)

Col. (3) — Difference between Col. (1) and Col. (2)

Note — Gas operations of Union do not reflect income of $180,131 for amounts received for prepaid gas (Ex. 14-1, Sch. 7, p. 1, L. 10, Col. 10) (R II 15)